

Money Makes the World Grow

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We know that growth isn't making us happy (see "GDP, or You and Me?" Jan. 2010), but that isn't quite the entire growth story. There's another reason that growth is "required," which all comes down to our system of money.

Our current monetary system relies on *fractional reserve banking*, meaning that when we deposit \$100, the bank keeps 10% in its vault, and loans out the other \$90 at interest. The banks thus create money: we still "have" our \$100, and can withdraw it at any time, but the bank has also given someone else \$90, so there's now \$190 in the economy.

The person with the loan then buys something with this newly created money, and the seller deposits the loaned \$90 in the bank. The bank again keeps 10% in the vault, and loans out the remaining \$81. The process is repeated until the vault contains the full \$100, and \$900 of loans have been created. This means that a tiny fraction of our money is that which is minted and printed by the government. Ninety percent is created through bank debt.¹

That banks not only hold, but *create*, our money is not an esoteric economic curiosity. It fundamentally affects every exchange in the market. As Bernard Lietaer writes in *The Future of Money*, the inescapable result of our current system of money is that it

...indirectly encourages systematic competition among the participants of the system.

...fuels the need for endless economic growth, even when standards of living remain stagnant.

...concentrates wealth by taxing the vast majority in favor of a small minority.²

The problem with creating money through loans is that the bank charges interest on them. While the bank appears to create \$90 of new money, it also creates more than \$90 (\$90 plus interest, let's call it \$100) of debt at the same time. The bank creates \$90 of money with which someone can pay, and \$100 of debt which someone must pay, so the person receiving the loan needs to find an extra \$10, or else they will be forced to default. They must go into the market, and use their \$90 to "make" \$100. But unlike banks, people can't actually *make* any money. All they can ever do is *take* money from someone else in the market.

Imagine that we have a market of ten people in which everyone has a \$90 loan, and is looking to get \$100 to pay them off. (This is obviously a gross oversimplification, but it represents the deeper truth that we can trace the vast majority of money back to loans from banks). Everyone in the market needs more than they have, and collectively, the group doesn't have enough money. They can't *all* pay back their loan. It follows directly from this fact that *some people need to take from others to be able to pay back their \$100*. If no

¹As we would expect, about 10% of our money is currency printed by the government. The rest is created by banks. Currency (Dec. 2007): \$759 billion M2 (Dec. 2007): \$7,447 billion Currency: <http://www.federalreserve.gov/releases/h6/hist/h6hist2.htm> M2 (Total Money): <http://www.federalreserve.gov/releases/h6/hist/h6hist1.htm>

²Lietaer, Bernard. (2002). *Future of Money: Towards Wealth, Work, and A Wiser World*. London: Random House Business. 103.

other loans are made (or in common parlance, if there's no "growth" in the economy), only nine people can make their payments. At least one will be forced to default.³ Our current monetary system manufactures this scarcity, and pits people against each other. Whether or not it is human nature, it is the nature of the system to compel competition.

The reason that this brutality is usually hidden from us is that there *are* other loans being made (or in common parlance, the economy "grows," with more and bigger loans each year). *There must be more and bigger loans each year ("growth in the economy") in order for the people to be able to pay, and in order for the bankers to reap their interest.* As long as there are more and bigger loans in the future, we can pay the bankers with money created by these loans, which will then be repaid with bigger future loans, and so on.

As such, our current system requires a growing economy, with more and bigger loans each year. Unfortunately, we cannot reasonably expect a finite Earth to support an exponentially growing economy forever, which means that our money is unsustainable. In addition, as the rich own most of the wealth that is loaned out at interest, and derive a growing profit from these loans, our money is also unjust at its core, constantly funneling wealth up the pyramid, to those who have more from those who have less.

The love of this money is the root of much evil, but it doesn't have to be this way. Money is simply a transferable contract, and many far kinder forms of contracts are possible. Find a way to fix this money, and we may find a way to fix the world.

³ In an economy with zero growth, a percentage of people equal to the interest rate will be forced to default. In this example, a 10% interest rate results in a 10% default rate.